# 3

# Monetary and Banking Developments

The conduct of monetary policy during 2003-04 was broadly in conformity with the stance and objectives of the Monetary and Credit Policy announced by the Reserve Bank in April, 2003. The key objective continued to be the provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level. An important issue of monetary management that arose in 2003-04 was to deal with the surge in foreign capital flows. During the year, foreign exchange assets of the Reserve Bank of India (RBI) increased by Rs. 1,26,169 crore. RBI had to moderate the impact of these inflows through open market sale of Government securities and repo operations through the Liquidity Adjustment Facility (LAF). The higher growth of broad money ($M_3$) in 2003-04 at 16.4 per cent as compared to the growth of 14.0 per cent indicated in the annual monetary and credit policy was in line with the higher output growth in the year. Reserve money growth at 18.3 per cent, was the highest in recent years. The higher growth was entirely driven by the increase in the net foreign exchange assets of the RBI. Net RBI credit to Government continued to decline due to open market sale of Government securities to neutralise the impact of large accretion to foreign exchange reserves.

3.2 The downward trend in interest rates continued in 2003-04. RBI reduced the Bank Rate from 6.25 per cent to 6.00 per cent from the close of business on April 29, 2003. The cash reserve ratio (CRR) was reduced by 25 basis points to 4.50 per cent in June, 2003. RBI's advice to scheduled commercial banks (SCBs) to announce benchmark prime lending rates (BPLRs) based on their actual costs fortified the transparency of loan pricing. There was a considerable pick up in the offtake of non-food credit from the second half of the year. A significant development in 2003-04 was the lower than budgeted market borrowings by the Central Government, facilitated by an improvement in the cash position. This, in particular, was aided by the receipts under the State debt-swap scheme, enabling the State Governments to substitute high cost debt owed to the Centre with market borrowings raised at relatively lower interest rates. During the year 2003-04, SCBs improved their profitability on account of higher income from treasury operations and higher spread.

## Monetary trends and developments

### Broad money ($M_3$)

3.3 $M_3$ grew by 16.4 per cent in 2003-04, higher than the expansion of 14.0 per cent envisaged in the annual monetary and credit policy statement but in consonance with the high growth in output during the year (Table 3.1). GDP growth in 2003-04, which had been put at 6.0 per cent in the annual policy statement and subsequently revised upwards in the mid-term review of monetary policy to the range of 6.5-7.0 per cent with an upward bias, was 8.1 per cent accoding to the advance estimates released by the Central Statistical Organisation (CSO) in February, 2004. The higher growth of $M_3$ in 2003-04 needs to be seen in the context of higher than-expected GDP growth in 2003-04.

3.4 Among the components of $M_3$, both currency with the public and deposits registered a higher growth in 2003-04 as compared with the previous year, adjusted for merger effects. Net foreign exchange assets of the banking sector registered a higher growth in spite of the redemption of the Resurgent India Bonds (RIBs) during the year. Investments in Government securities became very attractive to banks with interest on these instruments becoming market determined following the reforms initiated in the financial sector in the early nineties. Despite high growth of other banks' credit to Government, total net bank credit to the Government grew by a lower rate of 10.0 per cent in 2003-04 as compared with 14.4 per cent in the previous year on account of a significant reduction in net RBI credit to the Central Government by 67.3 per cent. The substantial reduction in net RBI credit to the Central Government was due to open market sales of securities exceeding the private placement and the Centre's surplus balances

**Table 3.1 : Sources of change in money stock ($M_3$)**

| Items | Outstanding balances as on | | Variations during | | | |
|---|---|---|---|---|---|---|
| | Mar 31, | | Mar 31, '02 to Mar 31, '03 | Mar 31,'03 to Mar 31,'04 | Mar 31, '02 to Mar 31, '03 | Mar 31,'03 to Mar 31,'04 |
| | 2003 | 2004 | | | | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| | Rs. crore | | | | Per cent | |
| **I. $M_1$ (Narrow Money)** | **472414** | **573170** | **49570** | **100756** | **11.7** | **21.3** |
| **II. $M_3$ (Broad Money) (1+2+3+4)** | **1719202** | **2000349** | **220846** | **281147** | **14.7** | **16.4** |
| 1. Currency with the public | 271382 | 316758 | 30587 | 45376 | 12.7 | 16.7 |
| 2. Demand deposits with banks | 197790 | 251371 | 18591 | 53581 | 10.4 | 27.1 |
| 3. Time deposits with banks | 1246788 | 1427179 | 171276 | 180391 | 15.9 | 14.5 |
| 4. "Other" deposits with RBI | 3242 | 5041 | 392 | 1799 | 13.8 | 55.5 |
| III. Sources of change in money stock ($M_3$) | | | | | | |
| **1. Net bank credit to Govt. (A+B)** | **674429** | **741969** | **84865** | **67540** | **14.4** | **10.0** |
| A. RBIs' net credit to Governent | 120679 | 44908 | -31498 | -75771 | -20.7 | -62.8 |
| (i) Central Government | 112985 | 36920 | -28398 | -76065 | -20.1 | -67.3 |
| (ii) State Governments | 7694 | 7988 | -3100 | 294 | -28.7 | 3.8 |
| B. Other banks credit to Government | 553750 | 697061 | 116363 | 143311 | 26.6 | 25.9 |
| **2. Bank credit to commercial sector (A+B)** | **892088** | **1011074** | **132441** | **118986** | **17.4** | **13.3** |
| A. RBIs' credit to commercial sector | 3048 | 2061 | -2881 | -987 | -48.6 | -32.4 |
| B. Other banks' credit to commercial sector | 889040 | 1009013 | 135322 | 119973 | 18.0 | 13.5 |
| **3. Net foreign exchange assets of the banking sector** | **393714** | **515304** | **82679** | **121590** | **26.6** | **30.9** |
| **4. Government's currency liabilities to the public** | **7071** | **7291** | **705** | **220** | **11.1** | **3.1** |
| **5. Banking sector's net non-monetary liabilities other than time deposits** | **248101** | **275288** | **79843** | **27187** | **47.5** | **11.0** |
| **Memorandum Items** | | | | | | |
| 1. Money multiplier ($M_3$) | 4.66 | 4.58 | | | | |
| 2. Velocity of money | 1.50 | 1.48 | | | | |
| 3. Net domestic assets | 1325488 | 1485045 | 138167 | 159557 | 11.6 | 12.0 |
| 4. Net domestic credit | 1566517 | 1753042 | 217306 | 186525 | 16.1 | 11.9 |

**Note : All figures are provisional. RBI data relate to end March after closure of Government accounts. Variations in respect of scheduled commercial banks (SCBs) are based on data for last reporting Friday of March. SCBs time deposits include Rs17, 945 crore on account of procedes from RIBs (Resurgent India Bonds), since August 28,1998 and Rs 25, 662 crore from India Millennium Deposits (IMDs) since November 17, 2000.**

with the RBI. In 2003-04, as against private placement of Government securities with RBI amounting to Rs.21,500 crore, sale of Government securities by RBI amounted to Rs.41,849 crore. With overdraft regulations for States becoming more stringent (from April, 2003, States cannot remain in overdraft for more than 36 days in a quarter), outstanding overdrafts of States witnessed a substantial reduction.

3.5 The money multiplier—the ratio of $M_3$ to reserve money—after increasing from 4.43 at end-March 2002 to 4.66 at end-March 2003, declined to 4.58 at end-March 2004. The income velocity of money—the ratio of gross domestic product at current market prices to the average money stock during the year—has been witnessing a continuous decline. It declined from 1.61 in 2001-02 to 1.50 in 2002-03 and further to 1.48 in 2003-04. This trend indicates more and more $M_3$ being used for transactions resulting in an increase in income of one rupee. (Table 3.1)

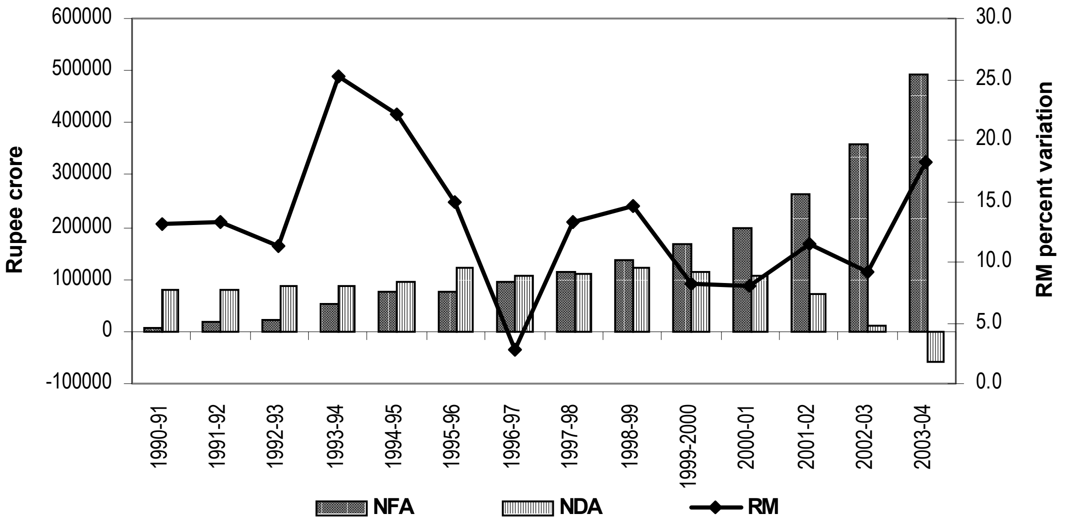
**Reserve money**

3.6 Reserve money grew by 18.3 per cent in 2003-04 as compared with 9.2 per cent in the previous year. The only source which had contributed to the higher growth in reserve money was the net foreign exchange assets of the RBI. Over the last few years, net foreign exchange assets of the RBI have been surging with large capital flows into the country. In 2003-04, these assets increased by 35.2 per cent as compared with 35.7 per cent in 2002-03 (Table 3.2). During the period 1994-95 to 1998-99, average annual accretion to foreign exchange reserves amounted to Rs.17,306 crore. This increased to Rs.69,292 crore in the period 1999-2000 to 2003-04. In 2003-04 alone, net accretion to RBI's foreign exchange reserves was Rs.1,26,169 crore. The increase in the foreign exchange assets of the RBI was partly neutralised by a corresponding reduction in the domestic assets. Trends in reserve money, net foreign exchange assets (NFA) and

**Table 3.2 : Components and sources of reserve money**

| | Outstanding balances | | Variations during | | Per cent variation | |
|---|---|---|---|---|---|---|
| | Rs. crore | | | | | |
| | March 31, 2003 | March 31, 2004 | 2002-03 | 2003-04 | 2002-03 | 2003-04 |
| **Reserve money** | **369061** | **436429** | **31090** | **67368** | **9.2** | **18.3** |
| **A : Components** | | | | | | |
| a. Currency in circulation | 282473 | 327023 | 31499 | 44550 | 12.6 | 15.8 |
| b. Banker's deposits with RBI | 83346 | 104365 | -801 | 21019 | -1.0 | 25.2 |
| c. "Other" deposits with RBI | 3242 | 5041 | 392 | 1799 | 13.8 | 55.5 |
| **B : Sources** | | | | | | |
| 1. Net RBI credit to Government | 120679 | 44907 | -31499 | -75772 | -20.7 | -62.8 |
| 2. RBI credit to banks | 7160 | 5419 | -3588 | -1741 | -33.4 | -24.3 |
| 3. RBI credit to commercial sector | 3048 | 2062 | -2881 | -986 | -48.6 | -32.3 |
| 4. Net foreign exchange assets of RBI | 358244 | 484413 | 94275 | 126169 | 35.7 | 35.2 |
| 5. Government's currency liabilities to the public | 7071 | 7291 | 705 | 220 | 11.1 | 3.1 |
| 6. Net non-monetary liabilities of RBI | 127141 | 107663 | 25921 | -19478 | 25.6 | -15.3 |
| **Memorandum items** | | | | | | |
| a. Net domestic assets of RBI | 10817 | -47984 | -63185 | -58801 | -85.4 | -543.6 |
| b. Net domestic credit by RBI | 130887 | 52388 | -37968 | -78499 | -22.5 | -60.0 |

Fig. 3.1 Trends in reserve money, NFA and NDA




net domestic assets (NDA) of RBI are depicted in Figure 3.1.

3.7 Dealing with the surge in capital flows became an important part of monetary management. The RBI has been moderating the impact of increase in capital flows through open market sale of Government securities held by it and through daily repo operations under the LAF. Both these operations, however, require an adequate stock of Government securities. The use of entire stock of securities for outright open market sales was constrained by allocation of a part of securities for day-to-day LAF operations as well as for investments of surplus balances of the Government. The stock of marketable Government securities held by the RBI declined to Rs. 44,217 crore as on March 31, 2004 from a level of Rs. 1,16,444 crore as on March 31, 2003. The RBI has taken a number of measures to supplement its stock of Government securities. These include the following :

- Raising the limit of 91- day treasury bills from Rs.500 crore to Rs.1,500 crore for eight auctions between August 6, 2003 and September 24, 2003.
- Conversion of the entire stock of Government of India treasury bills amounting to Rs. 61,818 crore into marketable securities, on a private placement basis.
- Acquisition of Government security by funding pre-payment of Government's external debt.

3.8 These measures were considered inadequate as capital flows continued to remain buoyant. The RBI constituted an Internal Working Group on Instruments of Sterilisation. Based on the recommendations of the Group, a scheme for launching market stabilisation bonds was formulated. The Government of India and the RBI signed a Memorandum of Understanding on March 25, 2004 detailing the rationale and operational modalities of the Market Stabilisation Scheme (MSS). The scheme became effective from April 2004. Main features of the scheme are listed in Box 3.1.

3.9 RBI also constituted an Internal Working Group on Liquidity Adjustment Facility. Based on its recommendations, a revised scheme of LAF was put in place effective March 29, 2004. The revised LAF scheme consists of i) 7-day repo conducted daily, ii) overnight fixed rate repo conducted daily, and iii) reverse repo auction on overnight basis at a fixed rate. The present 14 day repo will be phased out in due course. The overnight variable repo auction facility was continued till April 2, 2004 to

**Box 3.1 : Market stabilisation scheme**

- Government of India issues treasury bills or dated securities under the MSS in addition to normal borrowing requirements to absorb excess liquidity. These instruments indistinguishable from the present treasury bills and dated securities issued by the Government are eligible for the purposes of SLR and repo.
- Government of India in consultation with the RBI fixes an annual aggregate ceiling for treasury bills and/or securities under the MSS. The initial ceiling for 2004-05 is fixed at Rs. 60,000 crore, which is subject to revision.
- The amounts raised under the MSS is held in a separate identifiable cash account maintained and operated by the RBI.
- Payment of interest and discount not made from the MSS account but shown in the budget documents of the Government of India.
- Securities under the MSS are matched by an equivalent cash balance held by the Government with the RBI offsetting the monetary impact of accretion to the RBI's net foreign assets.

facilitate a smooth transition to the new scheme. Under the revised scheme, the repo rate is fixed by the RBI from time to time. The present repo rate of 4.50 per cent is retained for this purpose. The reverse repo rate will be 150 basis points higher than the repo rate. Increase in the minimum tenor of the LAF operations from overnight to seven days is expected to enable balanced development of various segments of the money market. Fixed rate repo auctions under the revised scheme, with the flexibility to conduct overnight repo, if the situation warrants, is intended to enhance the ability of the RBI to transmit policy signals to the market.

## Monetary and credit policy

3.10 Monetary policy formulation has become more complex, particularly in the context of changing magnitude and composition of capital flows to developing countries. Private capital flows now account for bulk of the long term capital flows. Private capital flows have increased significantly in recent years. In 2003-04, the conduct of monetary policy in India had to address the issue of surge in capital flows leading to increased purchase of foreign currency by the RBI, and consequent expansion of reserve money and money supply. In 2003-04, foreign exchange assets of the RBI (adjusted for revaluation) increased by Rs. 1,41,428 crore as compared with an accretion of Rs. 82,090 crore in 2002-03, resulting in excess liquidity. The liquidity was contained through open market sale of Government securities held by the RBI and repos under the LAF.

3.11 There was no change in the stance of the monetary and credit policy in 2003-04. The stance maintained its focus on providing adequate liquidity to meet credit needs and supporting investment demand in the economy, while continuing a vigil on movements in the price level. The policy also laid stress on the maintenance of a soft and flexible interest rate regime within the framework of macroeconomic stability. The annual policy statement had placed the growth rate of GDP at 6.0 per cent on the assumption of a satisfactory monsoon and rainfall at around 96 per cent of the long period average. Inflation was assumed to remain in the range of 5.0 to 5.5 per cent. Consistent with the projection of GDP growth and inflation, broad money growth in 2003-04 was projected at 14.0 per cent. Non-food credit was projected to increase by 15.5 to 16.0 per cent to facilitate and sustain the growth in the industrial sector. Monetary management in the first half of 2003-04 was broadly in conformity with the stance announced in the annual policy statement. A surge in foreign exchange reserves and lower demand for credit had put pressure on liquidity management. The cash reserve ratio was reduced from 4.75 per cent to 4.50 per cent in June 2003 augmenting the lendable resources of banks by about Rs.3,500 crore.

3.12 The mid-year review of the monetary and credit policy left the Bank Rate and CRR unchanged. The review placed GDP growth in 2003-04 in the range of 6.5-7.0 per cent as compared with the growth of 6.0 per cent projected in the annual policy. Projection of Inflation was lowered from the range of 5.0-5.5 per cent to 4.0–4.5 per cent. Main features of the annual monetary and credit policy and the mid-year review are summarised in Box 3.2.

### Annual policy statement 2004-05

3.13 The stance of monetary policy for 2004-05 has remained the same as in 2003-04. The stance, as indicated by the RBI in its annual policy statement (May 18, 2004) will be provision of adequate liqudity to meet

**Box 3.2 : Monetary and credit policy 2003-04**

**A: Annual policy statement**

- Bank rate reduced by 25 basis points to 6.0 per cent effective from the close of business on April 29, 2003.
- Cash reserve ratio (CRR) reduced by 25 basis points from 4.75 per cent to 4.50 per cent effective from June 14, 2003.
- Payment of interest on a monthly basis on eligible CRR balances maintained by banks with the RBI from April 2003.
- Continued extension of refinance facility to eligible export credit remaining outstanding under post-shipment credit beyond 90 days and up to 180 days.
- Multiplicity of rates under the Liquidity Adjustment Facility (LAF) rationalised.
- With a view to enhancing transparency in the pricing of loan products and ensuring that prime lending rate (PLR) reflects actual costs, banks advised to announce a benchmark PLR taking into account their actual cost of funds, operating expenses and minimum margin to cover regulatory requirement of provisioning/ capital charge and profit margin.
- Eligibility of dealers in drip irrigation/sprinkler irrigation system/agricultural machinery, irrespective of their location, for advances up to Rs. 20 lakh, under priority sector lending.
- Banks free to extend direct finance to the housing sector up to Rs.10 lakh in rural and semi-urban areas as part of priority sector lending.
- Stage II of the transition to a pure inter-bank call/notice money to be effective from fortnight beginning June 14, 2003 where non-bank participants allowed to lend, on average in a reporting fortnight, up to 75 per cent of their average daily lending in call/notice money market during 2000-01.
- Indian corporates and resident individuals to be permitted to invest in rated bonds/fixed income securities of listed eligible companies abroad, subject to certain conditions.

**B : Mid-term review**

- No change in Bank Rate and CRR.
- Banks advised to increase loan limit without collateral to small scale industries with good track record and financial position from Rs. 15 lakh to Rs. 25 lakh.
- Interest on deposits of foreign banks placed with Small Industries Development Bank of India (SIDBI) towards their priority sector shortfall to be at the Bank Rate.
- All new loans granted by banks to Non-Banking Financial Companies (NBFCs) for on-lending to SSI sector to be reckoned for the purpose of priority sector lending.
- In a further move towards pure inter-bank call/notice money market, lending by non-bank participants reduced from 75 per cent to 60 per cent of their average daily lending in call/notice money market during 2001-02.
- In view of development of the repro market as also to ensure balanced development of various segments of the money market, PDs allowed to borrow, on an averge in a reporting fortnight, up to 200 per cent of their net owned funds (NOF) as at end-March of the preceding financial year with effect from February 7, 2004.
- Adoption of 90 day norm for recognition of loan impairment for financial institutions from the year ending March 31,2006 with a view to aligning asset classification norms of banks and financial institutions.
- Foreign currency loans by banks above US $ 10 million to be extended to corporates only on the basis of a well laid out policy to ensure hedging except for loans to finance exports and for meeting forex expenditure.

credit growth and support investment demand and export demand in the economy while keeping a very close watch on the movements in the price level. Consistent with above stance, RBI has indicated that it will pursue an interest rate environment that is conducive to maintaining the momentum of growth and macro-economic and price stability. The annual policy statement has placed the growth rate of GDP in 2004-05 in the range of 6.5 to 7.0 per cent, assuming sustained growth in industrial sector, normal monsoon and good performance of exports. On the assumption of no signficant supply shocks and appropriate managment of liqudity, inflation rate in 2004-05, on a point to point basis, is placed at around 5.0 per cent.

3.14 Money supply ($M_3$) in 2004-05 is projected to expand by 14.0 per cent. Consistent with projected expansion in $M_3$, increase in aggregate deposits of scheduled commercial banks is set at Rs. 2,18,000 crore, which is 14.5 per cent higher over its level in the previous year. Non-food credit adjusted for investment in commercial paper, shares/ debentures/bonds of PSUs and private corporate sector is projected to increase by 16.0 to 16.5 per cent in 2004-05. Some initiatives for augmenting credit to agriculture from institutional sources by over 30 per cent in 2004-05 were announced on June 18, 2004. RBI has indicated that this magnitude of credit expansion is expected to meet adequately the credit needs of all the productive sectors of the economy. Main features of the annual policy statement for 2004-05 are listed out in Box 3.3.

### Interest rates

3.15 The RBI had continued its policy stance of soft interest rates and imparting greater flexibility to the interest rate structure. In consonance with this policy, RBI reduced the Bank Rate from 6.25 per cent to 6.0 per cent from April 29, 2003 and the CRR from 4.75 per cent to 4.50 per cent from June 14, 2003. Over

**Box 3.3 : Annual policy statement 2004-05**

- Bank Rate kept unchanged at 6.0 per cent.
- Repo rate kept unchanged at 4.5 per cent.
- A Gold Card Scheme for creditworthy exporters drawn up.
- Banks encourged to align the pricing of credit to assessment of credit risk to improve credit delivery and credit cutlure.
- The RBI accepted some recommendations of the interim Report of the Vyas Committee for implementation. These include, *inter-alia* loans for storage facilities under priority sector, securitised agricultural loans as priority sector lending, waiving margin/security requirements for certain agricultural loans up to a limit, NPA norms for crop loans aligned to crop seasons.
- Development of mechanism for debt restructuring for medium enterprises on the lines of corporate debt restructuring.
- Banks allowed to raise long-term bonds to finance infrastructure. Definition of infrastructure lending broadened and a Working Group constituted on Credit Enhancement by State Governments for financing infrastructure.
- Limit on the lending of non-bank participants in the call/notice money market reduced to 45 per cent effective June 26, 2004.
- The extant limit on unsecured exposures for banks withdrawn.
- Banks to draw a road map for migration to Basel II.
- Risk based supervision extended to more banks.
- Fresh licenses to UCBs only after a comprehensive policy.
- RBI sets up a Board for Payment and Settlement Systems.
- RTGS operationalised. RBI expects more commercial banks to join the RTGS system by June 2004.
- Reports of the Working Group on Financial Conglomerates, Working Group on Development Finance Institutions and Standing Committee on Procedures and Performance Audit on Public Services are being put in public domain.
- A panel of advisers reviewing the follow-up and future agenda on International Financial Standards and Codes.

the years, there has also been a softening of the repo rate. The repo rate witnessed moderation from 8.0 per cent in March 1999 to 4.5 per cent at present. Lower rates of inflation in recent years greatly facilitated the transition to a low interest rate regime. The soft interest rate regime was strengthened with the Government's decision to reduce rates of interest on public provident fund and small saving instruments effective from March, 2003. The RBI had reduced the interest rate on savings account, the only domestic deposit rate which continues to remain administered, from 4.0 per cent to 3.5 per cent per annum from March 1, 2003.

3.16 Between March 2002 and March 2004, deposit rates offered by major commercial banks on term deposits of more than one year maturity declined from a range of 7.50-8.50 per cent to a range of 5.00-5.50 per cent. In contrast, the prime lending rates (PLR) of five major commercial banks witnessed a smaller decline from a range of 11.00 –12.00 per cent to 10.25-11.00 per cent in the same period. The lending rates of banks by and large remained sticky as compared with the sharp fall in deposit rates. While corporates with good track record are able to access bank loans at below PLR, majority of borrowers are denied the benefit of falling deposit rates and the resultant lower cost of funds to banks. In order to enhance transparency in the pricing of loan products and to ensure that PLR reflects the actual cost, the RBI, had advised banks to announce BPLR taking into account actual cost of funds, operating expenses and a minimum margin to cover regulatory requirement. As at end-March 2004, almost all banks had adopted the new system of BPLRs, which were lower than their earlier PLRs by 25-100 basis points.

3.17 In order to provide consistency in interest rates offered to non-resident Indians, interest rates on NRE deposits were linked to LIBOR/SWAP rates for US Dollar from July 17, 2003. Interest rates on these deposits were reduced from 250 basis points above LIBOR/ SWAP rates to 100 basis points above LIBOR/ SWAP rates effective from September15, 2003 and further to 25 basis points above LIBOR/SWAP rates of corresponding maturity from October 18, 2003. From April 17, the above rate was further moderated to LIBOR/ SWAP rate and it was stipulated that interest rate on NRE savings depoists should not exceed the LIBOR/SWAP rates for six-month maturity on US dollar deposits. Trends in interest rates are given in Table 3.3.

**Table 3.3 : Trends in interest rates**

*(per cent per annum)*

| Interest rate | March 29, 2002 | March 28, 2003 | March 26, 2004 |
|---|---|---|---|
| Bank rate | 6.50 | 6.25 | 6.00 |
| IDBI[1] | 12.50 | 12.50 | 10.25 |
| Prime lending rate (PLR[2]) | 11.00-12.00 | 10.75-11.50 | 10.25-11.00 |
| Deposit rate[3] (> one year) | 7.50-8.50 | 5.25-6.25 | 5.00-5.50 |
| Call money (Borrowings) (low/high)[4] | 5.00/19.00 | 4.00/8.25 | 3.00/4.50 |
| CDs by SCBs | 5.00-10.03 * | 5.00-7.10 | 3.87-5.16 @ |
| CPs by companies( at face value)# | 7.41-10.25 | 6.00-7.75 | 4.70-6.50 |
| 91 days T-bills | 6.13 ** | 5.89 *** | 4.37 # |
| 364 days T-bills | 6.16 **** | 5.89 ***** | 4.44 # |

* Relates to March 22, 2002 ** Relates to March 27, 2002
*** Relates to March 26, 2003 **** Relates to March 20, 2002
***** Relates to March 19, 2003
@ Relates to March 19, 2004. # Relates to March 31, respective years.

Notes: 1. Minimum Term Lending Rate (MTLR).
2. Prime Lending Rate relates to five major banks.
3. Deposit rate relates to major banks for term deposits of more than one year maturity.
4. Data cover 90-95 per cent of total transactions reported by participants.

## Banking policy and trends

3.18 During the year 2003-04, banking sector reforms were carried forward with the introduction of risk-based supervision, issue of guidelines and directions under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, liberalisation of foreign direct investment in banking companies, and enhanced transparency in the pricing of loan products. During April-June 2003, RBI had introduced risk- based supervision (RBS) for a select few banks on a pilot basis parallel to regular on-site inspection. Based on the feedback, RBI proposes to extend RBS to all banks in a phased manner. It has been decided to extend the RBS with some modifications to 15 more banks during the year 2004-05. RBS aims at allocating supervisory resources in accordance with the risk profiles.

3.19 The RBI had issued final guidelines under the SARFAESI Act in April 2003. These guidelines covered aspects relating to registration and operations of asset reconstruction/securitisation companies. In addition to these guidelines, RBI had issued guidance notes of a recommendatory nature covering acquisition of assets and issue of security receipts. In order to facilitate sale of NPAs to securitisation companies (SCs)/ asset reconstruction companies (RCs), RBI had issued guidelines to banks/FIs, inter-alia, covering accounting treatment of sale of NPAs to SCs/RCs and investment in bonds/ debentures/security receipts and provisioning/ valuation norms, capital adequacy norms and exposure norms relating thereto. With a view to enabling banks to meet the shortfall, if any, resulting from sale of assets at a discount, banks were advised to build up provisions significantly above the minimum regulatory requirements for their NPAs, particularly for those assets which they propose to sell to securitisation/reconstruction companies.

3.20 An important policy announcement made in the year relates to the liberalisation of foreign direct investment in banking companies. In the Union Budget for 2003-04, Finance Minister announced the decision to raise the limit of foreign direct investment in banking companies from the present level of 49 per cent to 74 per cent. The Government had since issued a Press Note allowing the aggregate foreign investment in a private bank from all sources upto a maximum of 74 per cent of the paid up capital of the bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly owned subsidiary of a foreign bank. A foreign bank may operate in India through only one of the three channels, viz., (i) branches, (ii) a wholly owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank. These measures are expected to facilitate setting up of subsidiaries by foreign banks.

3.21 The focus of policy continued to remain on a soft interest rate regime. Policy initiatives were taken to inject transparency into the pricing of loan products. In its annual policy statement (April 2003), RBI had advised banks to announce BPLR taking into account cost of funds, operating expenses and requirement of provisioning. The RBI suggested discontinuation of tenor-linked PLR as all lending rates can be determined with reference to the BPLR. For smooth implementation of the new system, the Indian Banks Association (IBA) issued a circular to the member banks outlining broad parameters to be followed by banks for the computation of BPLR. Almost all commercial banks have adopted the new system of BPLR and the rates are lower in the range of 25-100 basis points from their earlier PLRs

3.22 Technical upgradation remained a priority area of banking sector reforms. RBI commenced implementation of the Real Time Gross Settlement (RTGS) system in a phased manner. A demonstrable version of the system was implemented in June 2003. Hands-on practice was given to officials of 104 banks. The system was made operational in March 2004. Inter-bank as well as customer related transactions are being put through the system.

### Currency management

3.23 During the year 2003-04, the RBI stepped up its efforts towards improvement of customer services in matters relating to issue of coins, acceptance of coins from public and exchange of soiled and mutilated notes. Adequate availability of coins in circulation has reduced the new demand for coins. An independent survey commissioned by the RBI during the year through the Administrative Staff College of India (ASCI) Hyderabad, in the states of Maharashtra, Madhya Pradesh, Gujarat and Karnataka, revealed a satisfaction level of 97 per cent in the matter of availability of coins. In order to tackle the reverse flow of coins, RBI offices and banks were advised to accept coins in exchange of notes or for deposit. The RBI reiterated its direction to all scheduled commercial banks to issue coins, accept coins and soiled notes in transactions or for exchange without any restriction. In order to facilitate the tendering of coins by members of the public over the counters and taking over of coins by cashiers, banks were advised to provide polythene sachets of predetermined capacity (100 coins) to members of the public. Banks were also advised to display notices, both inside and outside their branch premises, indicating the exchange facilities made available by them to members of the public.

3.24 The RBI's Department of Currency Management continued its efforts to improve the quality of notes in circulation. The process of mechanisation initiated in 1999 was carried forward by the Department by installation and commissioning of additional Currency Verification and Processing Systems with higher capacity of processing 50,000 to 60,000 bank notes per hour taking the total number of such systems to 48. Discontinuance of the age old practices of stapling of notes contributed to the circulation of more clean notes. With a view to ensuring that the benefits of clean note policy reaches the common people, banks were instructed to advise their branches to sort the notes and issue only clean notes to the public and remit the non-issuable notes to the currency chests/RBI issue offices. Banks were also instructed to provide table top note sorters to their currency chest branches and also large branches where large volumes of cash were handled daily.

3.25 The RBI has introduced a single window customer service at its issue offices under which coins of all denominations are either issued or accepted at one counter or notes of all denominations are either issued or accepted at one counter or notes of all denominations are either issued or accepted for exchange at one counter. Similarly, mutilated notes packed in a closed cover are now being accepted in a Drop Box even beyond normal banking hours without any limit.

### Financial performance

3.26 There was considerable improvement in the performance of SCBs in 2002-03. The ratio of net profits to total assets increased from 0.75 per cent in 2001-02 to 1.0 per cent in 2002-03, the highest in the last six years. Operating profits of SCBs increased from Rs.29,837 crore in 2001-02 to Rs.40,682 crore in 2002-03, registering an increase of over 36 per cent as compared with an average growth of 24 per cent in the previous six years. The ratio of operating profits to total assets increased from 1.9 per cent in 2001-02 to 2.4 per cent in 2002-03.

3.27 During 2002-03, total income of the SCBs increased by 14.1 per cent as compared with an increase of 11.4 per cent in expenditure. Within expenditure, while interest expenditure increased by 7.0 per cent, expenditure towards provisions and contingencies increased by as much as 29.3 per cent. The impending introduction of the 90-day norm for asset classification on portfolio basis from March 2005 prompted SCBs to make higher provisions. An analysis of income of SCBs reveals a marked change in its composition. The share of interest income has been declining on account of slower growth of credit and softening of interest rates. Growth of interest income in 2002-03 at 10.8 per cent was considerably lower than the growth of 31.5 per cent in other income. The Government securities market remained buoyant as a result of excess liquidity, declining yields and soft interest rates.

Active trading in Government securities resulted in an increase in trading profits. Though the growth of other income decelerated from 41.7 per cent in 2001-02 to 31.5 per cent in 2002-03, the share of other income in total income increased from 15.9 per cent to 18.4 per cent in the same period. The changing composition of income of SCBs reflects the changing composition of assets of the banking system. Between 1997-98 and 2002-03, while investments of SCBs recorded a compound annual growth rate of 20.6 per cent, advances recorded a lower growth of 18.0 per cent.

3.28 There were wide variations in the performance of SCBs across bank groups. Increase in income was the lowest for old private sector banks (3.0 per cent) and the highest for new private sector banks (108.6 per cent). Foreign banks witnessed a decline in their income as well as expenditure. While their income declined by 7.1 per cent, expenditure declined by 10.9 per cent. The higher decline in expenditure was mainly on account of containment of interest expenditure. Public sector banks (PSBs) experienced a higher growth of 9.6 per cent in their income and a lower growth of 6.6 per cent in their expenditure. In the case of PSBs, there was a substantial increase in other income by 28.6 per cent. Increase in interest expenditure of these banks was contained at just 1.0 per cent.

3.29 The ratio of net profits to total assets was the highest for foreign banks (1.6 per cent) followed by old private sector banks (1.2 per cent), PSBs (1.0 per cent) and new private sector banks (0.9 per cent). The ratio of operating profits to total assets followed more or less a similar pattern with foreign banks performing the best (3.2 per cent) followed by old private sector banks (2.7 per cent) and PSBs and new private banks (2.3 per cent each).

3.30 There was an increase in the provisions and contingencies for all bank groups, reflecting efforts to improve their credit portfolios. An exception to this was the foreign banks, which recorded a decline of 5.8 per cent in their provisions reflecting an improvement in their asset portfolio. Increase in provisions was the highest in the case of new private sector banks (99.7 per cent) followed by PSBs (30.3 per cent) and old private sector banks (4.1 per cent). (Table 3.4)

**Table 3.4 : Working results of scheduled commercial banks for 2001-02 and 2002-03**

| Items | SBI Group Banks | | Nationalised Banks | | Public Sector Banks | | Foreign Banks | | Old Pvt Sector Banks | | New Pvt. Sector Banks | | All SCBs | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2001-02 | 2002-03 | 2001-02 | 2002-03 | 2001-02 | 2002-03 | 2001-02 | 2002-03 | 2001-02 | 2002-03 | 2001-02 | 2002-03 | 2001-02 | 2002-03 |
| **Rs. crore** | | | | | | | | | | | | | | |
| A. Income | 44763 | 48867 | 72490 | 79598 | 117252 | 128465 | 12964 | 12043 | 10946 | 11279 | 9871 | 20587 | 151032 | 172374 |
| I) Interest Income | 38746 | 40869 | 61965 | 66325 | 100711 | 107194 | 9700 | 8972 | 8725 | 8918 | 7823 | 15635 | 126958 | 140718 |
| II) Other income | 6017 | 7998 | 10525 | 13273 | 16541 | 21271 | 3264 | 3071 | 2221 | 2361 | 2048 | 4952 | 24074 | 31656 |
| B. Expenditure | 41313 | 44356 | 67635 | 71814 | 108948 | 116170 | 11472 | 10219 | 9942 | 10047 | 9096 | 18861 | 139454 | 155297 |
| I) Interest expended | 26556 | 27207 | 42598 | 42646 | 69154 | 69853 | 6054 | 5065 | 6497 | 6327 | 5813 | 12361 | 87516 | 93607 |
| II) Intermediation cost | 9487 | 10431 | 16935 | 18466 | 26422 | 28897 | 3397 | 3250 | 1933 | 2147 | 1927 | 3791 | 33679 | 38085 |
| III) Provisions and contigenies | 5270 | 6718 | 8102 | 10702 | 13372 | 17420 | 2021 | 1904 | 1512 | 1573 | 1356 | 2708 | 18261 | 23605 |
| C. Operating profit (A-Bi-Bii) | 8720 | 11229 | 12957 | 18486 | 21677 | 29715 | 3513 | 3728 | 2516 | 2805 | 2131 | 4434 | 29837 | 40682 |
| D. Net profit (A-B) | 3450 | 4511 | 4855 | 7784 | 8305 | 12295 | 1492 | 1824 | 1004 | 1232 | 775 | 1726 | 11576 | 17077 |
| E. Total assets | 449289 | 493954 | 706109 | 791281 | 1155398 | 1285235 | 113321 | 116401 | 93229 | 105110 | 174477 | 192170 | 1536424 | 1698916 |
| **As per cent of total assets** | | | | | | | | | | | | | | |
| A. Income | 10.0 | 9.9 | 10.3 | 10.1 | 10.1 | 10.0 | 11.4 | 10.3 | 11.7 | 10.7 | 5.7 | 10.7 | 9.8 | 10.1 |
| I) Interest Income | 8.6 | 8.3 | 8.8 | 8.4 | 8.7 | 8.3 | 8.6 | 7.7 | 9.4 | 8.5 | 4.5 | 8.1 | 8.3 | 8.3 |
| II) Other income | 1.3 | 1.6 | 1.5 | 1.7 | 1.4 | 1.7 | 2.9 | 2.6 | 2.4 | 2.2 | 1.2 | 2.6 | 1.6 | 1.9 |
| B. Expenditure | 9.2 | 9.0 | 9.6 | 9.1 | 9.4 | 9.0 | 10.1 | 8.8 | 10.7 | 9.6 | 5.2 | 9.8 | 9.1 | 9.1 |
| I) Interest expended | 5.9 | 5.5 | 6.0 | 5.4 | 6.0 | 5.4 | 5.3 | 4.4 | 7.0 | 6.0 | 3.3 | 6.4 | 5.7 | 5.5 |
| II) Intermediation cost | 2.1 | 2.1 | 2.4 | 2.3 | 2.3 | 2.2 | 3.0 | 2.8 | 2.1 | 2.0 | 1.1 | 2.0 | 2.2 | 2.2 |
| III) Provisions and contigenies | 1.2 | 1.4 | 1.2 | 1.4 | 1.2 | 1.4 | 1.8 | 1.6 | 1.6 | 1.5 | 0.8 | 1.4 | 1.2 | 1.4 |
| C. Operating profit | 1.9 | 2.3 | 1.8 | 2.3 | 1.9 | 2.3 | 3.1 | 3.2 | 2.7 | 2.7 | 1.2 | 2.3 | 1.9 | 2.4 |
| D. Net profit | 0.8 | 0.9 | 0.7 | 1.0 | 0.7 | 1.0 | 1.3 | 1.6 | 1.1 | 1.2 | 0.4 | 0.9 | 0.8 | 1.0 |

3.31 During the first quarter of 2003-04, the financial performance of SCBs improved further. Due to further containment of interest expenditure, net profits to total assets of SCBs for the quarter ended June 2003 was 0.32 per cent as compared with 0.24 per cent in the previous corresponding quarter.

**Table 3.5 : Net interest income (Spread) of SCBs**

| Banks/years | 2000-01 | 2001-02 | 2002-03 |
|---|---|---|---|
| **Rs. crore** | | | |
| 1. Public sector | 29,436 | 31,557 | 37,340 |
| 1.1 Nationalised banks | 18,188 | 19,367 | 23,678 |
| 1.2 State banks group | 11,249 | 12,190 | 13,662 |
| 2. Old private sector banks | 2,123 | 2,229 | 2,591 |
| 3. New private sector banks | 1,685 | 2,009 | 3,273 |
| 4. Foreign banks | 3,707 | 3,646 | 3,907 |
| SCBs | 36,950 | 39,441 | 47,111 |
| **As per cent of total assets** | | | |
| 1. Public sector | 2.86 | 2.73 | 2.91 |
| 1.1 Nationalised banks | 2.90 | 2.74 | 2.99 |
| 1.2 State banks group | 2.79 | 2.71 | 2.77 |
| 2. Old private sector banks | 2.51 | 2.39 | 2.46 |
| 3. New private sector banks | 2.14 | 1.15 | 1.70 |
| 4. Foreign banks | 3.63 | 3.22 | 3.36 |
| SCBs | 2.85 | 2.57 | 2.77 |

## Interest spread

3.32 A notable development in 2002-03 was the increase in the net interest income or spread of SCBs by 19.5 per cent (Table 3.5). With the exception of foreign banks, all bank groups recorded a double-digit increase in spread mainly on account of containment of interest expenditure due to falling interest rates, particularly on deposits. The ratio of spread to total assets had increased for all bank groups in 2002-03. The ratio was the highest for foreign banks (3.4 per cent), followed by public sector banks (2.9 per cent), old private sector banks (2.5 per cent) and new private sector banks (1.7 per cent). Expanding spread is also indicative of the fact that lending rates have remained sticky and have not fallen as much as the deposit rates.

## Non-performing assets of the banking sector

3.33 In order to improve the performance of SCBs, recovery management is being given top priority in recent years. Measures taken to contain NPAs include reschedulement/ restructuring at the bank level, corporate debt restructuring, recovery through Lok Adalats, Civil Courts and Debt Recovery Tribunals and compromise settlements. The recovery management got a fillip with the enactment of SARFAESI. There was a sharp decline in the gross NPAs from Rs.70,861 crore in 2001-02 to Rs.68,715 crore in 2002-03. Net NPAs declined from Rs.35,554 crore to Rs.32,764 crore in the same period. While the incremental gross NPAs of PSBs declined by Rs.2,387 crore, those of private (old and new) and foreign banks increased by Rs.138 crore and Rs.103 crore, respectively. The ratios of gross and net NPAs to advances and total assets have been declining across all bank groups (Table 3.6). The ratio of gross NPAs to

**Table 3.6 : Non-performing assets of scheduled commercial banks**

| Items | Gross NPAs (Rs. crore) | | | | Percentage to gross advances | | | | Percentage to total assets | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1999-2000 | 2000-01 | 2001-02 | 2002-03 | 1999-2000 | 2000-01 | 2001-02 | 2002-03 | 1999-2000 | 2000-01 | 2001-02 | 2002-03 |
| **Bank Group** | | | | | | | | | | | | |
| 1. Public Sector | 53033 | 54672 | 56473 | 54086 | 14.0 | 12.4 | 11.1 | 9.4 | 6.0 | 5.3 | 4.9 | 4.2 |
| 2. Private Sector | 4761 | 5963 | 11662 | 11800 | 8.2 | 8.4 | 9.6 | 8.1 | 3.6 | 3.7 | 4.4 | 4.0 |
| 3. Foreign | 2614 | 3106 | 2726 | 2829 | 7.0 | 6.8 | 5.4 | 5.2 | 3.2 | 3.0 | 2.4 | 2.4 |
| 4. SCBs (1+2+3) | 60408 | 63741 | 70861 | 68715 | 12.7 | 11.4 | 10.4 | 8.8 | 5.5 | 4.9 | 4.6 | 4.0 |
| | Net NPAs (Rs. crore) | | | | Percentage to net advances | | | | Percentage to total assets | | | |
| 1. Public Sector | 26187 | 27977 | 27958 | 24963 | 7.4 | 6.7 | 5.8 | 4.5 | 2.9 | 2.7 | 2.4 | 1.9 |
| 2. Private Sector | 3031 | 3700 | 6676 | 6883 | 5.4 | 5.4 | 5.7 | 5.0 | 2.3 | 2.3 | 2.5 | 2.3 |
| 3. Foreign | 855 | 785 | 920 | 918 | 2.4 | 1.8 | 1.9 | 1.8 | 1.0 | 0.8 | 0.8 | 0.8 |
| 4. SCBs (1+2+3) | 30073 | 32462 | 35554 | 32764 | 6.8 | 6.2 | 5.5 | 4.4 | 2.7 | 2.5 | 2.3 | 1.9 |

gross advances for all SCBs declined from 12.7 per cent in 1999-00 to 8.8 per cent in 2002-03.

3.34 An analysis of NPAs by sector reveals that, in 2002-03, advances to non-priority sectors accounted for bulk of the outstanding NPAs in the case of public sector banks (50.7 per cent) and private banks (78.6 per cent).

### Capital adequacy ratio

3.35 At end-March, 2003, capital to risk weighted assets ratio (CRAR) for PSBs stood at 12.6 per cent, higher than the level of 11.8 per cent as at the end of March, 2002. All the PSBs had CRAR above the stipulated minimum of 9 per cent in 2002-03. Of the 27 PSBs, as many as 26 banks had CRAR exceeding 10 per cent. In the case of 30 private sector banks operating in India, only two bank, viz., Centurion Bank with a CRAR of just 2.0 per cent and Global Trust Bank with zero CRAR were below the minimum requirement of 9 per cent.

## Bank credit

3.36 There was adequate liquidity in the banking system in 2003-04 to support a credit pick up. Total bank credit (food and non-food) increased by 14.6 per cent in 2003-04 as compared with 16.1 per cent (net of mergers) in the previous year. In sharp contrast to the acceleration witnessed in 1999-2000 and 2000-01, food credit declined steeply by 27.3 per cent in 2003-04 after a decline of 8.3 per cent in the previous year. The steep decline in food credit was on account of lower procurement and higher offtake of foodgrains. Flow of non-food credit, which remained subdued in the first two quarters, started picking up from the third quarter of 2003-04. Offtake of non-food credit in the last two quarters of 2003-04 amounted to Rs.1,01,407 crore, much higher than the amount of Rs.71,980 crore in the corresponding quarters of the previous year. For the year as a whole, non-food credit grew by 17.6 per cent as compared with a growth of 18.6 per cent (net of mergers) in 2002-03. Incremental non-food credit in 2003-04 amounted to Rs.1,19,684 crore as compared with Rs. 99,448 crore (net of mergers) in the previous year. With improvement in industrial production, the pick up in non-food credit witnessed since September, 2003 is likely to be sustained.

### Investment

3.37 In addition to extending credit, SCBs invest in approved securities under SLR and in instruments such as commercial paper, shares, bonds and debentures issued by the private corporate sector and public sector undertakings. During 2003-04, SCBs invested an amount of Rs.1,29,828 crore in Government securities and an amount of Rs.2,283 crore in other approved securities. There was a decline in the growth of investments in Government securities from 27.3 per cent in 2002-03 to 24.8 per cent in 2003-04. Investments in other approved securities grew by 9.5 per cent as compared with a decline of 10.9 per cent in 2002-03. There was an off-loading of non-SLR investments by Rs.3,805 crore in 2003-04 as compared with an investment of Rs.11,853 crore in 2002-03.The decline in non-SLR investments was spread across all the instruments,viz., commercial paper, shares and bonds. The investment-deposit ratio increased from 42.7 per cent in 2002-03 to 45.3 per cent in 2003-04.

### Sectoral deployment of bank credit

3.38 Information on sectoral deployment of bank credit relates to 48 SCBs accounting for about 90 per cent of bank credit of all SCBs. During the year 2003-04, total gross bank credit registered a marginally lower growth of 14.2 per cent as compared with a growth of 14.9 per cent in the previous year. The decline in food credit witnessed in 2002-03 continued in 2003-04. In 2003-04, food credit declined by 27.3 per cent on account of lower procurement of foodgrains and higher offtake from the public distribution system. Non-food credit in 2003-04 registered a growth of 17.5 per cent, the same as in the previous year. Within non-food credit, advances to priority sectors registered a higher growth. Among the priority sectors, credit to agriculture increased from 17.9 per cent in 2002-03 to 23.2 per cent in 2003-04. Credit to small scale sector increased from 5.7 per cent in 2002-03 to 9.0 per cent in 2003-04. Growth of credit to medium and large industries was lower than that recorded in the previous year. The sectors which witnessed higher growth in credit were consumer durables and tourism.

3.39 In recent years, housing and consumer durables have emerged as new drivers of growth of non-food credit. The share of these sectors in outstanding non-food credit of SCBs increased to 8.2 per cent at the end of March, 2004 as compared with a share of 6.1 per cent at the end of March 2002. Credit for housing increased by 42.1 per cent in 2003-04 on top of a 55.1 per cent increase during 2002-03. In 2003-04 flow of credit to housing and consumer durables was Rs.16,449 crore constituting 15.2 per cent of the total flow of non-food credit. (Table 3.7)

**Priority sector lending**

3.40 The target fixed for priority sector lending by domestic and foreign banks is 40 per cent and 32 per cent of their net bank credit (NBC), respectively. Public sector banks, as a group, have met the target of priority sector lending. At the end of March, 2003, priority sector lending by PSBs amounted to 42.5 per cent of their NBC. Outstanding priority sector advances by private sctor banks constituted 44.4 per cent of NBC at the end of March, 2003 as compared with 40.9 per cent a year ago. Outstanding advances by foreign banks to priority sectors amounted to 33.9 per cent of their NBC. While there was a significant improvement in the share of priority sector lending by private sector banks from 40.9 per cent of NBC as at end-March 2002, to 44.4 per cent as at end-March, 2003 foreign banks witnessed a marginal reduction in their priority sector advances as proportion to NBC. As regards PSBs, there was improvement in the

**Table 3.7: Sectoral deployment of gross bank credit**

| | Outstanding balances[1] | | | | Variations during[1] | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2001-02 | 2002-03 | 2002-03# | 2003-04# | 2001-02 | 2002-03 | 2003-04# | 2001-02 | 2002-03 | 2003-04# |
| | Rs. crore | | | | | | | per cent | | |
| I. Gross bank credit | 536727 | 616906 | 669534 | 764383 | 67574 | 80179 | 94849 | 14.4 | 14.9 | 14.2 |
| 1. Public food credit | 53978 | 49479 | 49479 | 35961 | 13987 | -4499 | -13518 | 35.0 | -8.3 | -27.3 |
| 2. Gross non-food credit | 482749 | 567427 | 620055 | 728422 | 53587 | 84678 | 108367 | 12.5 | 17.5 | 17.5 |
| (a) Priority sectors (i+ii+iii)[2] | 175259 | 203799 | 211609 | 263834 | 20845 | 28540 | 52225 | 13.5 | 16.3 | 24.7 |
| i. Agriculture[3] | 60761 | 71609 | 73518 | 90541 | 8839 | 10848 | 17023 | 17.0 | 17.9 | 23.2 |
| ii. Small scale industry | 57199 | 60486 | 60394 | 65855 | 1197 | 3287 | 5461 | 2.1 | 5.7 | 9.0 |
| iii. Other priority sector | 57299 | 71704 | 77697 | 107438 | 10809 | 14405 | 29741 | 23.3 | 25.1 | 38.3 |
| (b) Medium and large industries | 172324 | 200335 | 235168 | 247210 | 9487 | 28011 | 12042 | 5.8 | 16.3 | 5.1 |
| (c) Wholesale trade (excluding food procurement) | 20459 | 22398 | 22578 | 24867 | 2614 | 1939 | 2289 | 14.6 | 9.5 | 10.1 |
| (d) Other sectors | 114707 | 140895 | 150700 | 192511 | 20641 | 26188 | 41811 | 21.9 | 22.8 | 27.7 |
| Of which: | | | | | | | | | | |
| (1) Housing | 22346 | 34654 | 36587 | 51981 | 6203 | 12308 | 15394 | 38.4 | 55.1 | 42.1 |
| (2) Consumer durables | 7015 | 6904 | 7219 | 8274 | 1449 | -111 | 1055 | 26.0 | -1.6 | 14.6 |
| (3) Real estate loans | 2596 | 3098 | 5894 | 5577 | 830 | 502 | -317 | 47.0 | 19.3 | -5.4 |
| (4) Tourism and tourism related hotels | 1540 | 1806 | 2428 | 3269 | 544 | 266 | 841 | 54.6 | 17.3 | 34.6 |
| (5) Loans to individuals[4] | 1520 | 1762 | 2001 | 2020 | -177 | 242 | 19 | -10.4 | 15.9 | 0.9 |
| II. Export credit[5] | 42978 | 49402 | 49202 | 57687 | -343 | 6424 | 8485 | -0.8 | 14.9 | 17.2 |

1. As on the last reporting Friday of the year.
2. Excluding investments in eligible securities.
3. Indirect finance not included.
4. Against shares and debentures/bonds
5. Included under gross non-food credit.
\# Includes the impact of meger of ICICI with ICICI Bank.

Note: Figures for 2003-04 are provisional. Data relate to 48 SCBs which account for 90 per cent of the bank credit of all SCBs. Gross credit data include bills rediscounted with RBI, IDBI, Exim Bank and other approved financial institutions.

share of priority sector lending from 42.5 per cent of NBC as at end-March 2003 to 44.5 per cent as at end-September, 2003.

3.41 While all the bank groups met the overall targets under priority sector lending, there were shortfalls in meeting the sub-targets set for agriculture and weaker sections of the society. For PSBs, advances to agriculture constituted 15.9 per cent of NBC, falling short of the sub-target of 18 per cent. Outstanding advances to weaker sections constituted 7.2 per cent of NBC at the end of September, 2003 falling short of the sub-target by 2.8 percentage points. At the end of March 2003, outstanding advances to agriculture and weaker sections by private sector banks constituted 10.8 per cent and 1.5 per cent of NBC, respectively. To improve credit delivery to the agriculture sector, the RBI in its annual monetary policy statement for 2003-04 extended the limit of Rs.20 lakh on advances granted to dealers in drip irrigation/sprinkler irrigation system/ agricultural machinery, located in rural and semi-urban areas to all areas. The sub-targets for foreign banks operating in the country are 10 per cent of NBC for the small scale industry (SSI) sector and 12 per cent of NBC for export credit. Export credit does not form part of priority sector lending for domestic banks. Outstanding advances towards export credit by foreign banks constituted 18.7 per cent of their NBC at the end of March, 2003, exceeding the target by 6.7 percentage points. There was a shortfall in meeting the target set for SSI lending by these banks by 1.3 percentage points.

3.42 The declining share of the SSI sector in the outstanding priority sector advances of public and private sector banks since 1999-2000 is a cause for concern. The share of SSI advances in the NBC declined from 16.1 per cent at the end of March, 1999 to 11.1 per cent at the end of March, 2003 in respect of PSBs. For the private sector banks, the share declined from 18.8 per cent to 8.3 per cent in the same period. There is no sub-target for advances to SSI sector by domestic banks.

3.43 The limited access of SSI sector to funds needs to be addressed on a priority basis. Large corporates are able to access bank loans at below PLR besides accessing international markets. But, for the SSI sector, the cost of funds continues to remain high despite falling deposit rates. Banking institutions need to upgrade their credit assessment capabilities so that a clear distinction can be made between bad and good credit. The RBI in its mid-year review of monetary and credit policy for 2003-04 had announced a number of measures aimed at improving credit delivery to the SSI sector. These measures included raising the loan limit from Rs.15 lakh up to Rs.25 lakh without the requirement of collateral, rationalising interest rate on the deposits of foreign banks placed with the Small Industries Development Bank of India (SIDBI) towards their priority sector shortfall (reduction of interest from 6.75 per cent to the prevailing bank rate) and mandating SIDBI to take appropriate steps to ensure that priority sector funds are utilised expeditiously and the benefit of reductions in interest rates is passed on to borrowers. In addition, all loans granted by banks to Non-Banking Financial Companies (NBFCs) for the purpose of on-lending to the SSI sector would also be reckoned under priority sector lending.

3.44 In its annual policy statement for 2004-05, the RBI announced new measures to improve the credit delivery mechanism, specially to improve credit flows to priority sectors and infrastructure. These include a waiver of margin/secuirty requirment for agricultural loans, coverage of loans for storage units under priority sector representing indirect agricultural finance, treatment of securitisation of agricultural loans under priority sector and fixing NPA norms for agricultural finance.

### Sensitive sector lending

3.45 Lending by SCBs to sensitive sectors comprise capital market, real estate and commodities. Outstanding lending to these sectors amounted to Rs.23,947 crore at the end of March, 2003 as compared with Rs.20, 820 crore at the end of March, 2002. The exposure of SCBs to sensitive sectors had undergone a compositional change in 2002-03. The share of real estate in total

| Table 3.8 : Lending to sensitive sectors | | | | | |
|---|---|---|---|---|---|
| Banks | 2001-02 | 2002-03 | Per cent variation | Per cent share in total | |
| | Rs. crore | | | 2001-02 | 2002-03 |
| A. SCBs | 20820 | 23947 | 15.0 | 100.0 | 100.0 |
| B. PSBs | 13577 | 15375 | 13.2 | 65.2 | 64.2 |
| i. Nationalised | 11379 | 13286 | 16.8 | 54.7 | 55.5 |
| ii. State Bank Group | 2198 | 2088 | -5.0 | 10.6 | 8.7 |
| C. New Pvt. banks | 3134 | 4453 | 42.1 | 15.1 | 18.6 |
| D. Old Pvt. banks | 2708 | 2591 | -4.3 | 13.0 | 10.8 |
| E. Foreign banks | 1401 | 1528 | 9.0 | 6.7 | 6.4 |

outstanding lending to the sensitive sectors increased to 52.0 per cent at the end of March, 2003 as compared with 43.3 per cent a year ago. This was mainly on account of aggressive marketing of housing loans by most banks. Of late, lending to the housing sector has emerged as the major driver of the offtake of credit. The SCBs offloaded their exposure to the capital market in 2002-03 on account of lacklustre performance of the capital market. Accordingly, the share of capital market in total sensitive lending came down to 10.5 per cent in 2002-03 from 14.8 per cent a year ago. Exposure to commodities also came down to 37.5 per cent from 41.9 per cent in the same period. Details regarding lending to sensitive sectors are given in Table 3.8.

### Rural infrastructure development fund (RIDF)

3.46 Agriculture and rural infrastructure sectors have been witnessing a deceleration in public investment since the Eighth Five-Year Plan. This is mainly because of the severe resource crunch faced by the States, which are primarily responsible for the development of agriculture and rural infrastructure. Compounding the problem was shortfall in the priority sector lending to agriculture by the SCBs. It is against this background that the Government of India announced a scheme for setting up of RIDF in 1995-96. Under the scheme, domestic commercial banks contribute to the Fund to the extent of their shortfall in their lending to the priority sectors. The main objective of the Fund is to provide loans to State Governments and State-owned corporations to enable them to complete on-going rural infrastructure projects. The Fund is being operated by the National Bank for Agriculture and Rural Development (NABARD). The corpus of RIDF I-IX amounted to Rs. 34,000 crore at end-March, 2004. The allocation during 2003-04 was Rs. 5,500 crore under RIDF-IX. Cumulative sanctions and disbursements under RIDF tranches I to IX amounted to Rs. 34,678 crore and Rs.21,067 crore, respectively at the end of March 2004. As on March 31, 2004, RIDF loans amounting to Rs. 14,004 crore were outstanding from various State Governments. Concerned over the significant shortfalls in the disbursal of RIDF funds, the scope of RIDF lending was extended to cover soil conservation, rural market yards, inland water ways, fish jetties, cold storages, godowns and more recently rural health centres, primary school buildings, mini hydel plants, citizen information centres under information technology in addition to irrigation projects and rural roads. Under RIDF IX, Government of India had advised NABARD to sanction loans for projects which directly benefit the farmers. Accordingly, 60 per cent of sanctions from the corpus of Rs.5,500 crore provided under RIDF IX was earmarked for flood protection, irrigation, agriculture and allied activities and system improvement and mini hydel power projects. Interest rate on loans under RIDF had been reduced from 13.0 per cent in 1995-96 to 11.5 per cent in 2000-01 and further to 8.5 per cent in

2002-03. Considering the declining trend of interest rates, the lending rates in respect of undisbursed amount of RIDF tranches IV to IX was restructured with effect from November 1,2003 with the approval of RBI. Accordingly, State Governments would be required to pay 7 per cent in respect of undisbursed amount of RIDF IV to VII and Bank Rate plus 0.5 percentage point in respect of RIDF VIII and IX. The banks would be paid 6 per cent in respect of the undisbursed amount of RIDF IV to VII uniformly and varying rates of interest between the Bank Rate and Bank Rate minus 3 percentage points in respect of RIDF VIII to IX. The rates of interest on deposits in the case of RIDF VIII and IX will continue to be linked to the shortfall in lending to agriculture. (Table 3.9)

**Table 3.9 : Rate of interest on RIDF deposits**

| Sl. No. | Shortfall in lending to agriculture in terms of percentage to net bank credit | Rate of interest on the entire deposits to be made in RIDF VIII and RIDF-IX (Per cent per annum) |
|---|---|---|
| 1. | Less than 2 percentage points | Bank Rate (6% at present) |
| 2. | 2 and above, but less than 5 percentage points | Bank Rate minus 1 |
| 3. | 5 and above, but less than 9 percentage points | Bank Rate minus 2 |
| 4. | 9 percentage points and above. | Bank Rate minus 3 |

3.47 Assistance under RIDF has resulted in the addition of 78.8 lakh hectares of irrigation potential and 1,46,535 kilometres of roads by the end of November, 2003.

3.48 In the Interim Budget for the year 2004-05, an announcement was made regarding the setting up of Lok Nayak Jai Prakash Narayan Fund (LNJPNF), also called Agricultural Infrastructure and Credit Fund, with NABARD with a corpus of Rs. 50,000 crore spread over three years (April 2004 to March 2007). The objective of the Fund is to create mechanism for efficiently aggregating resources from various providers of long term financing, facilitating resource flow from the market and channelising for agriculture/rural infrastructure creation. The Fund will thus be utilized for enhancing the efficiency, productivity and profitability of Indian agriculture so as to augment the income of rural households by strengthening infrastructure necessary for agriculture, agri-exports, diversification and value addition. Consequent to the operationalisation of the LNJPNF, the RIDF mechanism has been discontinued.

### Kisan credit cards

3.49 Kisan credit cards (KCC) scheme was introduced in 1998-99 to improve credit delivery to farmers. The scheme is being operated by cooperative banks, regional rural banks (RRBs) and SCBs. The KCC scheme has been progressing well; and the number of cards increased from 6.1 lakh at the end of March 1999 to 413.8 lakh at the end of March 2004. Cooperative banks accounted for the bulk of the cards issued (58.6 per cent) followed by PSBs (32.0 per cent) and RRBs (9.4 per cent). The Government of India has set a time frame of March, 2004 for covering all eligible farmers under the scheme. For meeting this time frame, banks have been advised to work out a simple action plan. NABARD has advised banks to organise campaigns and banker-borrower meets to ensure coverage of all eligible farmers by March 31,2004. In addition, NABARD has taken the following initiatives.

- Provision of financial assistance under Cooperative Development Fund to cooperative banks for publicity campaigns.
- Financial support to RRBs under the R&D Fund to take up publicity campaigns in North-Eastern States. This scheme has also been extended to other parts of the country.
- Publicity through postal media. Under this scheme, printing order for 10 lakh Meghdoot post cards at a cost of Rs. 17.1 lakh has also been placed with the postal authorities.

3.50 In order to assess the impact of the scheme, RBI entrusted a survey to National Council of Applied Economic Research (NCAER), New Delhi. The survey conducted by NCAER covered 11 States by selecting 2 representative States from each of the five zones, that is, East, West, Central, North, South and one State from the North-East. From the 54 districts chosen for the survey, a total of 433 bank branches were selected and from each selected village a sample size of both KCC holders and non-KCC holders in the ratio of 10:2 was selected. The draft report of the survey is being examined.

3.51 Loans disbursed under KCC are now covered under Rashtriya Krishi Beema Yojana of the General Insurance Corporation. KCC holders are being provided personal accident insurance cover of Rs. 50, 000 for accidental death and Rs. 25, 000 for permanent disability.

### Micro finance

3.52 Sustained access of the poor to micro-finance services is a key element in addressing the problem of poverty. Despite the availability of nearly 1.5 lakh retail credit outlets of the formal banking system, including co-operatives in the rural areas, nearly 36 per cent of rural households depended on informal sources of finance, according to the All-India Debt and Investment Survey of 1991. To strengthen credit delivery in the rural areas, the programme of linking self help groups (SHGs) of the rural poor with the banking system was launched in 1992 as a pilot project. Over the last decade, this flagship savings-led micro finance innovation has come to symbolise an enduring relationship between the financially deprived and the formal banking system. The focus under the SHG-bank linkage programme is largely on the rural poor comprising small and marginal farmers, agricultural and non-agricultural labourers, artisans and craftsmen. The uniqueness of the programme is the zero subsidy. There are three models of credit linkage of SHGs with banks, viz., SHGs formed and financed by banks, SHGs formed by formal agencies other than banks but financed by banks, and SHGs financed by banks using NGOs and other agencies as financial intermediaries. SHGs formed by formal agencies account for a predominant share of SHG-bank linkage (72 per cent). SHGs formed by banks and SHGs financed through NGOs account for 20 per cent and 8 per cent of the total, respectively.

3.53 The programme of micro finance has been making rapid strides. By March 2004, 10.8 lakh SHGs were linked with banks. Around 90 per cent of these SHGs are exclusively formed by women. Cumulative assistance extended by over 30,000 branches of 504 banks that participated in the programme amounted to Rs.3,904 crore by March 31, 2004. During the year 2003-04, 3.62 lakh new SHGs were extended loans by banks up from 2.56 lakh new SHGs that got such loans in 2002-03. Loans disbursed in 2003-04 amounted to Rs. 1,855 crore as compared with 1,022 crore disbursed in 2002-03 (Table 3.10). NABARD extended cumulative refinance support amounting to Rs.2,125 crore to these banks. The programme has been recognised as the largest and fastest growing micro-finance programme in the world. An impact assessment study conducted by the NABARD in 2000 revealed that there was a marked improvement in the

**Table 3.10 : Progress of SHGs and bank linkage**

| Year | Total SHGs financed | | | Bank loan (Rs. crore) | | |
|---|---|---|---|---|---|---|
| | During the year | | Cumulative | During the year | | Cumulative |
| | Amount | % Growth | | Amount | % Growth | |
| 1992-99 | 32,995 | | 32,995 | 57.1 | | 57.1 |
| 1999-00 | 81,780 | 148 | 114,775 | 135.9 | 138 | 193.0 |
| 2000-01 | 149,050 | 82 | 263,825 | 287.9 | 112 | 480.9 |
| 2001-02 | 197,653 | 33 | 461,478 | 545.5 | 89 | 1,026.3 |
| 2002-03 | 255,882 | 29 | 717,360 | 1,022.4 | 87 | 2,048.7 |
| 2003-04 | 361,731 | 41 | 107,9091 | 1,855.5 | 81 | 3,904.2 |

asset base and income and employment levels of households covered under micro finance.

3.54 Despite the rapid progress of micro finance, there are two main areas of concern. The first concern relates to the limited coverage of poor families. Out of the 52 million poor families, only 16 million poor families (30.8 per cent) were covered under the programme by March 31, 2004. The second area of concern is the uneven spread of the programme. Andhra Pradesh accounted for 39 per cent of the total SHGs linked to credit, followed by Tamil Nadu, Karnataka and Uttar Pradesh. At end March 2003, these four States accounted for 69 per cent of total SHGs linked to credit. To address these concerns, NABARD has intensified its efforts to scale up the programme in the States of Assam, Bihar, Chattisgarh, Jharkhand, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh and West Bengal, which account for the bulk of the poor. In addition, special efforts are being made to popularise the programme in North-Eastern and hilly States. NABARD had reduced interest rate on refinance to 6 per cent per annum for loans up to Rs. 50,000 per member to incentivise the banking system to step up credit flow to SHGs. Table 3.10 presents the progress of SHGs and bank linkage.

## Non-banking financial companies (NBFCs)

3.55 Non-banking financial entities comprise NBFCs, mutual benefit financial companies (Nidhi companies), and mutual benefit companies (potential Nidhi companies). All these entities were being regulated by the RBI till September 29, 2003. From September, 2003, Department of Company Affairs had taken over the regulation of mutual benefit financial companies and mutual benefit companies, leaving the regulation of NBFCs with the RBI. Over the years, the RBI has strengthened the supervisory framework for NBFCs. The RBI's regulatory framework for NBFCs, though similar to that of SCBs to a large extent, differs in a number of areas to account for the unique features of NBFCs. The regulations are relatively more stringent in the case of deposit-accepting companies. There is a ceiling on the interest rates offered by NBFCs on deposits. With a view to aligning the interest offered by the NBFCs with those prevailing in the banking sector, RBI reduced the maximum rate that could be offered by the NBFCs from 12.5 per cent per annum to 11.0 per cent per annum with effect from March 4, 2003. As per the RBI directive, rates offered by NBFCs on NRI deposits cannot exceed those prescribed for SCBs. Effective April 24, 2004 NBFCs cannot accept fresh NRI deposits but can renew the existing NRI deposits.

3.56 As on March 31, 2003 there were 13,831 NBFCs registered with the Reserve Bank. Out of these, 730 were deposit accepting NBFCs. Total outstanding public deposits of 872 reporting NBFCs [including Miscellaneous Non-Banking Companies (MNBCs), Mutual Benefit Financial Companies (MBFCs) and Mutual Benefit Companies (MBCs)] amounted to Rs. 20,098 crore at the end of March, 2003 as compared with outstanding deposits of Rs. 18,822 crore held by 910 reporting NBFCs a year ago. Residuary Non-Banking Companies (RNBCs) accounted for 74.9 per cent of total deposits held by NBFCs at the end of March 2003. Of the 872 reporting NBFCs, 40 NBFCs had CRAR of less than 12 per cent. Over three-fourth NBFCs had CRAR of more than 30 per cent as at end of March 2003. Aggregate assets of deposit taking NBFCs as on March 31, 2003, declined to Rs. 47,777 crore from Rs. 52,049 crore as on March 31, 2002. However, the aggregate assets have marginally increased to Rs. 49,034 crore as on September 30, 2003.

3.57 The ratio of gross NPA to total assets declined from 10.6 per cent at the end of March 2002 to 9.2 per cent at the end of March 2003. The net NPAs also declined from 3.9 per cent to 1.8 per cent during the same period. NBFCs registered a net profit of Rs. 339 crore in 2002-03 compared with a net loss of Rs. 212 crore in 2001-02 mainly on account of reduction in financial cost.

## All India financial institutions (AIFIs)

3.58 All-India Financial Institutions (AIFIs) now comprise five all-India development banks (AIDBs), two specialised financial institutions (SFIs) and six investment institutions. ICICI and UTI were part of the AIFIs till 2002-03. Following the merger of ICICI with ICICI Bank and repeal of UTI Act 1963 and reorganisation of UTI into two separate institutions, these two institutions no longer inhabit the operational domain of AIFIs. AIFIs are undergoing structural changes in their role and operations following the ongoing reforms in the financial sector. AIFIs, which are predominantly engaged in the business of project financing, are fast losing ground with the entry of commercial banks into project financing. The withdrawal of concessional sources of funds and imposition of restrictions on raising short-term funds of maturity less than one year had resulted in AIFIs raising high cost debt from the market. The cash flow got adversely affected as a result of these institutions borrowing for a relatively short term of 3-4 years and investing in long gestation projects. Analysis done by the RBI reveals that the share of loans in total project financing has been coming down over the years followed by a significant increase in the share of equity. Share of loans in project cost has come down from a level of 53.5 per cent in the period 1970-71 to 1974-75 to a level of 43.0 per cent in the period 1995-96 to 2000-01. During the same period, the share of equity witnessed a sharp increase from 28.5 per cent to 53.0 per cent. Thus, AIFIs have been facing the problem of reduced demand for project financing and increased competition from commercial banks.

3.59 As a considered response to the above developments and drawing upon international experience in similar circumstances, several AIFIs are gearing up to migrate to an acceptable and viable variant of commercial banking to gain a foothold in the emerging financial system. ICICI had opted for a reverse merger with ICICI Bank in March 2002. Government has drawn up a roadmap for corporatisation and conversion of IDBI into a commercial bank, albeit without forsaking its obligations as a financial institution. The enactment of IDBI (Transfer of Undertaking and Repeal) Act 2003 will enable IDBI's conversion into a commercial bank. The proposal for merging IFCI with Punjab National Bank, which received the approval of the Boards of both the institutions, is under consideration.

3.60 The focus of policy initiatives in 2003-04 relating to financial institutions remained on imparting operational flexibility and strengthening the prudential regulatory and supervisory framework. The RBI had issued final guidelines to financial institutions prescribing group-wise prudential norms for capital adequacy, large exposures and liquidity gaps on August 1, 2003. FIs were advised to frame fair practices code regarding applications for loans and their processing, loan appraisal and terms and conditions.

3.61 The declining trend in the sanctions and disbursements of AIFIs observed since 2001-02 was halted in 2003-04. Sanctions by AIFIs increased by 67.9 per cent from Rs.38,963 crore in 2002-03 to Rs.65,433 crore in 2003-04 as compared with a negative growth of 8.3 per cent in the previous year. Bulk of this increase in sanctions was accounted for by investment institutions. Disbursements increased by 25.0 per cent in 2003-04 compared with a negative growth of 10.4 per cent in 2002-03 (Table 3.11). While the growth of disbursements of development financial institutions (DFIs) continued to

**Table 3.11 : Assistance by AIFIs**

| | 2001-02 | 2002-03 | 2003-04 |
|---|---|---|---|
| A. Sanctions | | | |
| 1. DFIs | 34220 | 33296 | 35954 |
| 2. Investment institutions | 8247 | 5667 | 29479 |
| **Total** | **42467** | **38963** | **65433** |
| B. Disbursements | | | |
| 1. DFIs | 26410 | 25490 | 23811 |
| 2. Investment institutions | 10380 | 7488 | 17402 |
| **Total** | **36789** | **32978** | **41213** |

**Notes:**
1. **Excluding ICICI and UTI**
2. **Data are provisional and not adjusted for their institutional flows.**
3. **DFIs include All-India Development Banks and specialised financial institutions**

remain negative in 2003-04, disbursements by investment institutions registered an increase of 132.4 per cent in contrast to the negative growth of 27.9 per cent registered in the previous year.

## Outlook

3.62 Broad objectives and parameters of the monetary and credit policy for 2003-04 have been met. An overall assessment of the developments during 2003-04 and prospects for 2004-05, provide grounds for optimism. However, the hardening of the international prices of oil and non-oil commodities and the persistence of large capital inflows are likely to remain important issues which could affect monetary conditions in 2004-05. Sterilisation of capital flows through open sale of Government securities involves quasi-fiscal costs in the form of the difference between the interest rate on domestic securities and return on foreign exchange reserves. Sterilisation, if it exerts an upward pressure on the interest rates, could result in attracting more foreign currency inflows, thus necessitating more intervention by the monetary authority. Sterilisation, at best, is a temporary policy instrument to address to inflows. With the improvement in macro-economic situation, it is likely that the present surge in capital flows will continue in the medium term. Therefore, in the medium to long term, policy initiatives aimed at improving the country's absorptive capacity need to be put in place.

3.63 Interest rates have been softening in recent years. However, a major concern with regard to interest rates is the downward rigidity observed in lending rates. Lending rates have remained sticky and have not fallen as much as the deposit rates. As a result, interest spread of commercial banks witnessed an increase during 2001-02 and 2002-03. Lending rates declined markedly for large top rated borrowers, which have access to funds at sub-PLR rates. However, lending rates have not declined commensurately for other borrowers. The RBI’s advice to commercial banks to put in place a system of BPLRs and bank’s subsequent announcement of BPLRs, which were lower than their earlier PLRs somewhat addressed the problem. The Reserve Bank has also advised that banks should align the pricing of credit to the assessment of credit risk so that credit delivery and credit culture is improved. Measures already taken and being taken by the RBI for improving the credit delivery mechanism are expected to further ease the rigidities in lending rates. This will help to strengthen and sustain the current revival in the industrial sector.